

Business Model Analysis for the Entrepreneur (p175)

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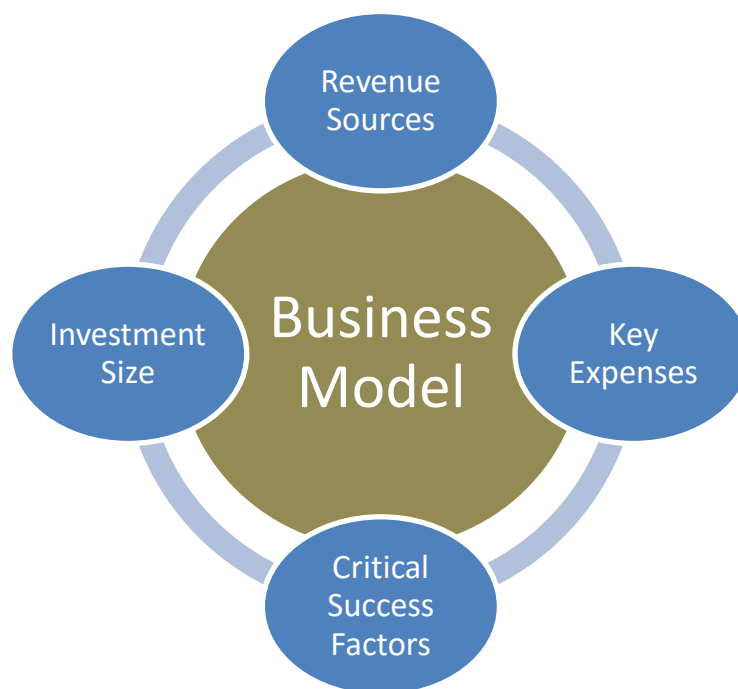
Synopsis

What are the defining elements of a business model for an entrepreneur?

Contained within are analytical techniques to help answer the following questions

1. How likely is the business to turn cash flow positive?
2. How much time is required to ramp-up the revenue in order to turn cash flow positive?
3. How large an investment is required to pursue the business model?
4. What are the critical success factors and associated risks?

For the entrepreneur a business model is ***a summation of the core business decisions and trade-offs employed by a company to earn a profit.***



Trade-offs exist between the following elements;

<i>Revenue sources</i>	What are the different revenue streams?
<i>Key expenses</i>	Which costs have the greatest impact and how may these change?
<i>Investment size</i>	Initial capital investment and working capital requirements to run the business?
<i>Critical success factors</i>	Most important elements to achieve profit, how difficult are they and how do they change?

1. Initial Analysis

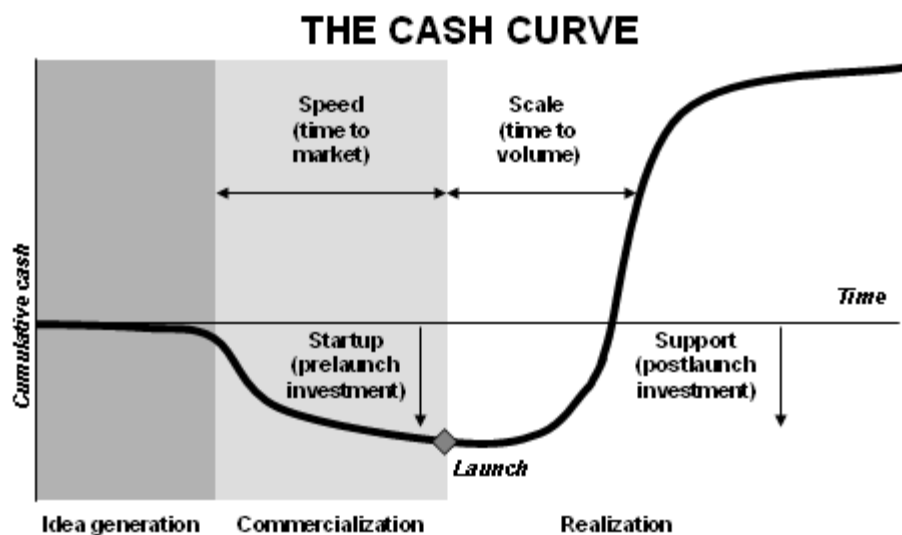
As a starting point for business model analysis examine actual and [pro forma](#) or budgeted financial accounts of balance sheet, income statement and cash flow statement. Additional sources include,

- Mission statement
- Business overview
- Strategic goals
- Operating principles

1.1 Analysis

Financial analysis should be performed

- Determine actual and projected revenues along with timing of cash inflows
- Determine actual and projected expenses and the timings of cash outflows
- How much cash needs to be invested to achieve positive cash flow, include working capital
- Plot cash flow against time to generate the **cash curve**
- Perform a *sensitivity analysis* on financial projects to identify **critical success factors**, or levers of greatest impact



Source: *Payback: Reaping the Rewards of Innovation*,
Harvard Business School Press, 2007

The **cash curve** provides a visual representation of the stage of a project that is not attainable from financial measures such as *Net Present Value* (NPV) or *Internal Rate of Return* (IRR).

2. Revenues

Determine the revenue drivers

<i>Revenue Sources</i>	<i>Revenue Models</i>
<ul style="list-style-type: none"> • Single stream • Multiple streams • Interdependent – <i>complementary products</i> • Loss leader – <i>product which loses money for interdependent custom</i> 	<ul style="list-style-type: none"> • Subscription/membership • Volume/unit-based • Advertising-based • Licensing and syndication • Transaction fee ...

2.1 Revenue Analysis

<i>Revenue Streams</i>	<i>Revenue Models</i>
What is the revenue source type? If a loss leader will the excess be redeemed?	The underlying revenue models, single or hybrid? How quickly will revenues increase? Are there barriers to revenue growth? What is cash collection period?

3. Costs

Determine the *cost drivers*, which are any factors that affect total costs. The dominant cost driver characterizes the overall cost structure.

<i>Cost Types</i>	<i>Cost Structures</i>
<ul style="list-style-type: none"> • Fixed • Semi-variable (< directly proportional) • Variable (directly proportional) • Non-recurring 	<ul style="list-style-type: none"> • Payroll-Centred (Support); fixed costs • Payroll-Centred (Direct); semi-variable costs • Inventory • Space/Rent • Marketing/Advertising

3.1 Cost Analysis

<i>Cost Driver</i>	<i>Cost Centre</i>
Which cost types are prominent How much volume can current cost base support Are any primary cost drivers expected to change	What are the largest cost centres What is their relative size and importance Do cost centres deliver <i>strategic cost advantage</i>

4. Investment Size

- Maximum investment** is the amount of cash required to achieve a positive cash flow
- Burn Rate** is that rate at which reserves are being consumed (the tangent of the cumulative cash flow)
- Cash Breakeven** is when cumulative cash flow becomes positive
- Maximum Financing Need** is the minimum cumulative cash flow
- Positive Cash Flow** – remember that there is no guarantee of remaining positive

p182 Medical Devices example interesting	Consider risks related to outsourcings critical functions
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5. Critical Success Factors

"An operational function or competency that a company must possess in order to become sustainable and profitable."

- Sensitivity analysis** can determine parameters or success factors of greatest impact.
 - Construct a model illustrating the timing and size of future cash flows
 - Select a few parameters with greatest perceived impact
[Sales growth, customer acquisition rate, inventory turns, ...]
 - Define a reasonable range for each parameter and measure the impact of changes (across the entire range)
 - Repeat for each variable to determine which parameter has the greatest impact

Critical Success factor Examples

Subscription/Membership	Customer retention; acquisition rate; ability to increase charges
Transaction-based	Ability to command premium price without high costs; economies of scale
Advertising-based	Ability to maintain advertising revenues in counter-cyclic economy; ability to increase advertising expenditure per customer

6. Bibliography

- Andrew, J. P., & Sirkin, H. L. (2007). *Innovations Payback*. Retrieved 2012, from The Street: <http://www.thestreet.com/story/10359793/1/innovations-payback.html>
- Hamermesh, R. G., Marshal, P. W., & Pirmoh, T. (2002). *Business Model Analysis for the Entrepreneur*. Retrieved 2011, from Harvard Business Review: <http://hbr.org/product/note-on-business-model-analysis-for-the-entreprene/an/802048-PDF-ENG?Ntt=Business%2520Model%2520Analysis%2520for%2520the%2520Entrepreneur>